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DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

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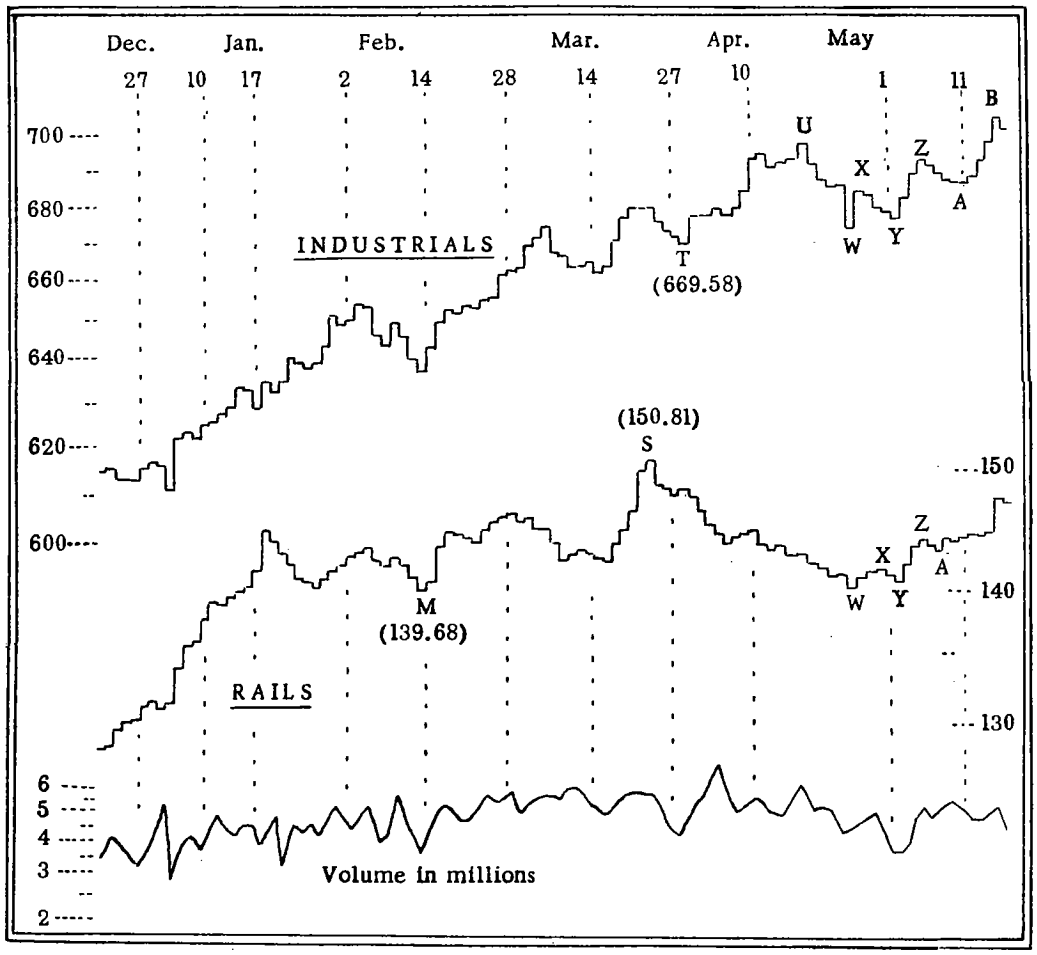
THE MARKET Following the W-X-Y "buy-spot" formation described in Letter 142, the two Averages worked steadily higher. On May 9 the Rail Average bettered the little rally peak at Z (see chart), and on May 15 the Industrials followed by bettering their own peak at Z.

On May 12 activity finally came into the "big stocks", the type of stocks which represent the "backbone of the economy". This constructive indication was followed up last week. For instance, on May 12 (Friday) and May 15 (Monday) volume on the Exchange was identical -- 4.84 million shares. But significantly, on those two days volume in the thirty stocks which make up the D-J Industrial Average rose from 251 to 365 thousand shares. Thus investors were seen to be moving into the cyclical issues which most affect the gross national product and the economy. In the parlance of Wall Street, "leadership improved".

On May 16 Industrials rallied above the bull market high at U with the Dow stocks obviously taking over complete leadership. May 17 saw heavy (and long awaited) buying in the Rail issues. By the close of that day Rails had registered a gain of 3.04, and Industrials had gained 7.78 to close above 700 for the first time in history.



It is of interest that the advance-decline ratio (Letter 143) has risen to successive new highs, and these highs were confirmed by the Industrial bettering of the 696.72 (U) peak on May 16.

The Industrial advance above U was, of course, a primary penetration into new high ground for the bull market. In the majority of cases primary penetrations do not occur simultaneously (both Averages going to new highs together). For this reason, as long as Rails continue to move in direction with Industrials

we can give them the benefit of the doubt. In due time they should better their high of 150.81 at S.

When the primary and secondary trends are well established (as is the case at present), it is best to lean on the old Dow Theory adage which states that the trend will continue until reversed. While this may sound like semantics, it is not as naive as it sounds. To illustrate, ever since Letter 139 (April 6) I have repeated in each Letter that the primary and secondary trend were bullish and would remain bullish as long as Industrials held above T and Rails held above M. Despite a few scary declines, the T and M points held intact. If a market will not go down, it will go up. This is exactly what has happened. In other words, we took the last bullish trend to remain in force until proved otherwise. Downside proof was not forthcoming, and the market rallied.

As of this writing the primary and secondary trends continue to point up. When the eventual reversal comes we will hope to uncover hints of it in the price structure. So far, the hints are not in evidence. However, it might be well at this time to mention one point. A persistent divergence in the Averages has often been the first indication of impending trouble. If one Average were suddenly to begin declining while the other Average advanced the situation could be dangerous. Although it is not necessary for the two Averages to better (confirm) previous points simultaneously, it has been demonstrated that in healthy markets the two indicators tend to move together as if "locked in gear".

The current rally began for Industrials at W (672.66), and the rise to B (705.51) added 33 points to the senior Average in a matter of four trading days. It would now be perfectly normal to have a 1/3 to 1/2 correction. If one or both Averages can hold above the preceding A points (Indust. 686.05, Rails 143.62) as volume contracts, the secondary trend will remain bullish. Conversely, if the A points are jointly broken on heavy volume there is a good chance that the secondary trend will have turned down.

On the sell-off of May 18 volume contracted sharply while odd-lotters stepped up both their selling and short selling. All three factors are bullish.

ODD-LOTS During each period of market weakness which developed between October, 1960, and the present, one or both Averages were able to hold above preceding lows. This in itself is a rather remarkable performance, and in view of this feat it would be well to review one technical indicator which has remained bullish throughout the rise -- odd-lot transactions. (see Letters 137 and 139).

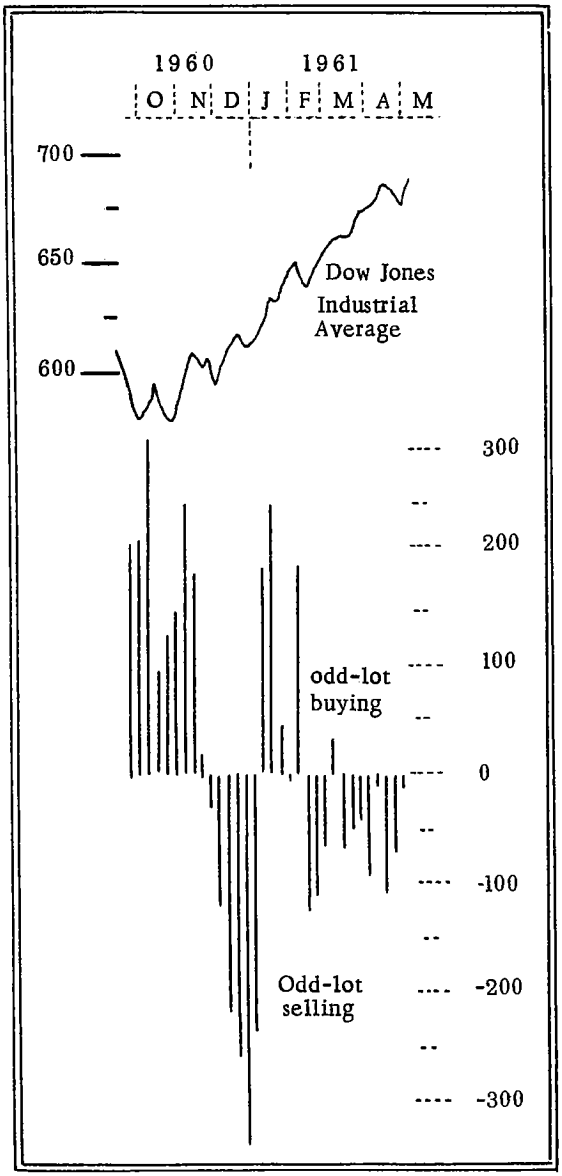
The chart on page 3 shows weekly net balances of odd-lot sales over purchases (or vice versa if purchases were more than sales). For instance, during the week ending April 7, 1961, the official S.E.C. figures show that odd-lotters bought 3.061 thousand shares while selling 3.077 thousand shares. Thus, the net balance for that week was 16 thousand shares sold, and this is entered on the chart as -16.

Note that net weekly sales balances by odd-lotters occurred in 18 of the 23 weeks since November 25, 1960. Of the five weeks in which net buying balances took place, four of those weeks occurred in the January-early February, 1961 period. Historically, the new year almost always brings in odd-lot buying balances since this is the time when many dividends and extra payments are automatically reinvested in new purchases.

The picture up to the present, then, is one in which the odd-lot public has unloaded as the market moved higher. The Industrials are now in the 680-700 area, and it is significant that back in January, 1960 (when the Industrials were also in this area) odd-lotters were buying heavily. Then they were enthusiastic and certain that prices were headed higher. Now the odd-lot public seems convinced that stocks (in the same area) should be sold. This consistent skepticism on the part of the public must be considered as a technical plus.

A comparison of the 1958 period and the current one is informative. During the period of June to October, 1958 (with only a two week respite), odd-lotters sold more than they bought. That odd-lot selling area lasted five months. The D-J Industrials were at 440 when the selling area began, and the Industrial advance carried 238 points (to 678 in August, 1959) before the market topped out.

Taking the period from the last week in November, 1960, to the present, the odd-lotters have now sold for a period of almost six months. The D-J Industrials were at 600 when the current odd-lot selling area began. While this should definitely not be taken as a prediction, an exact repeat of the 1958-59 performance would take the D-J Industrials to 838. Obviously, however, there are many major differences between today's market and the market of 1957-59 -- not the least of which is values.

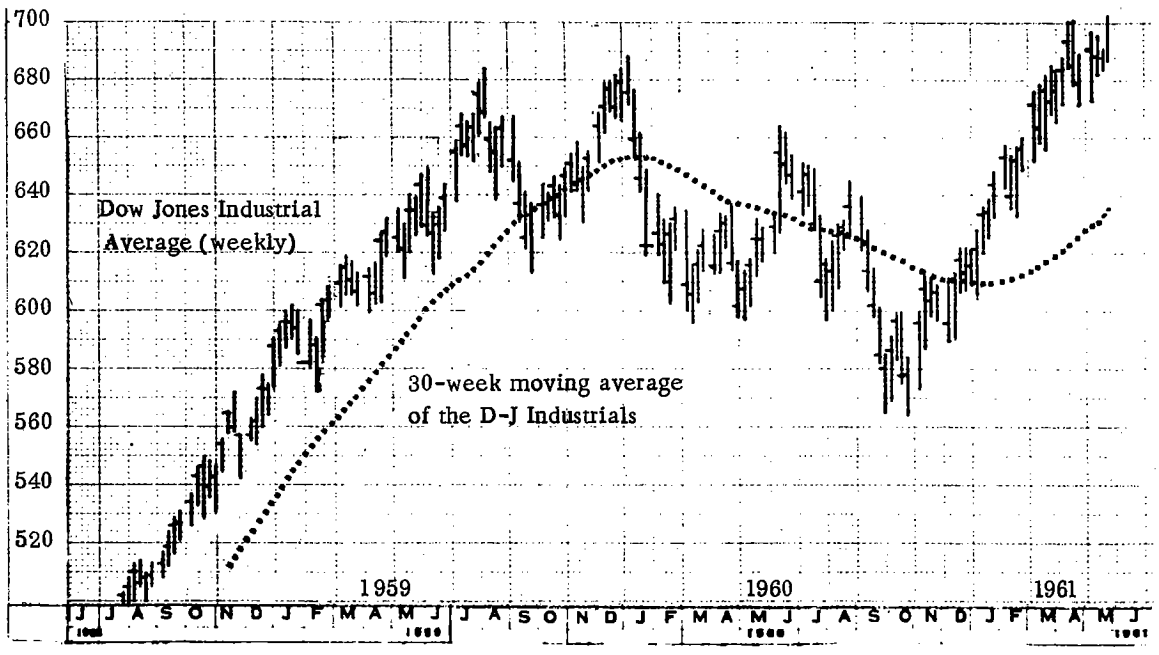


THE MOVING AVERAGE The long-term or 30-week moving average of the D-J Industrials is important because it shows the average price which investors have been willing to pay for the "blue-chip" D-J stocks over the last 30 weeks (or seven months). As seen on the chart, the D-J Industrial Average broke above its own 30-week moving average in January, 1960 (see Letter 129), and since that time the Industrial Average has held well above the moving average.

During February and March, 1961, the moving average itself began climbing, and this was a bullish indication (see Letter 137). The relationship of the D-J Industrials to their own 30-week moving average must be considered bullish as long as Industrials hold above a moving average which itself is in a rising trend.

During the great 1957-59 advance the Industrials held above the 30-week moving average for 65 consecutive weeks (until August, 1959). During September, 1959, the Industrials plunged temporarily below the moving average and this proved to be one of the earliest signs of impending trouble.

Referring to the current rise, the Industrial Average has now held above the 30-week moving average for 24 consecutive weeks. During those 24 weeks no Industrial decline has so much as approached the area of the long-term moving average. The comparison of the current rise with the 1957-59 rise does not imply that there must now be another period of 65 weeks during which the Industrials will hold above the rising moving average. But we can say that the bullish relationship between the Industrials and their own 30-week moving average remains definitely in force.



STOCK PAGE I mentioned in a previous Letter that one friend of mine trades almost exclusively in U. S. Steel and that he does outstandingly well with this single issue. With the market at

an all-time high, I have received an increasing amount of correspondence from subscribers who wish more information on individual stocks and more in the way of continuing information. For this reason I have decided to keep a running commentary on thirteen important stocks (most of them of the wide-swinging cyclical variety) in the D-J Industrial Average and two of the more important stocks in the D-J Rail Average.

This procedure should be instructive and (I hope) profitable to subscribers. The stocks below represent some of the "big guns" of the market and the economy. What they do affects the market, the economy, the gross national product and the nation's employment. It will be interesting to follow their trends from week to week. The stocks are: Alcoa, Amer. Tel., Anaconda, duPont, Eastman Kodak, Gen. Elect., Gen. Motors, Goodyear, Int. Harvester, Int. Paper, Sears Roebuck, Standard of Jersey, U. S. Steel, N. Y. Central, and Southern Pacific. Five of the stocks will be reviewed in this Letter, five in the next, the last five in the third Letter and then back again to the first five.

ALCOA (AA) Letter 141 showed AA testing its 30-week moving average (M. A.) for the fourth time this year. M. A. now stands at 71, and AA held within a point of that figure on its most recent dip -- then rallied. Trend on AA appears bullish, but the stock should be sold on a close under 68. Buy near 70.

EASTMAN KODAK (EK) M. A. now 111. Has held close to this figure for 10 weeks. Short interest rose slightly in latest period (after 2 month dip) which is hopeful. Could be bought on the theory that if it continues to hold above its M. A. the next major move will be up.

GENERAL ELECTRIC (GE) Letter 141 recommended purchases at 61. GE is still under its M. A. which is 69 1/2. May need more "work" but the stock is turning bullish. Short interest rose to a high of 54 thousand after dipping slightly last month. A rise over 70 in price should send GE on its way.

GOODYEAR (GT) Recommended in Letter 135 around 36. Last week (see chart) GT rose above its M. A. which now stands at 37. I believe GT can still be bought in the 40-42 range.

NEW YORK CENTRAL (CN) Letter 139 showed chart of CN with its M. A. at 17 3/8. Latest decline carried CN to 17 1/2 where it held -- then rallied. I consider CN a reasonable speculation as long as it holds above 17. CN down from its high of 33 in 1959 - represents a good speculation based on any concerted movement in the Rail Average.

The second chart shows St. Regis Paper which is now acting well and is in a position for buying. SRT is well down from its 1959 high, the short position is now listed at 44 thousand shares, and a rise above 41-42 should move it sharply higher.

Note: Eastern Airline (chart shown last Letter) omitted the dividend and the stock dropped sharply. I would continue to hold EAL as long as it stays above 26.

Chart of St. Regis Paper courtesy of Traders Research Inc., 6185 Lambert Airport, Missouri.

(Written Saturday, May 20th.)